BEFORE THE NEBRASKA PUBLIC SERVICE COMMISSION

In the Matter of the Nebraska Public Service Commission, on its own motion, seeking to investigate the use of expense caps in the earnings calculation for Nebraska universal service fund support.	)))))	Application No. NUSF-64

COMMENTS OF THE RURAL INDEPENDENT COMPANIES

The Rural Independent Companies (the "Companies") hereby submit their comments in response to the Order entered in this proceeding on June 3, 2008 (the "Order") by the Nebraska Public Service Commission (the "Commission"). The Companies appreciate the opportunity to provide their comments regarding the development of an inflation factor for the expense cap model adopted in the Order, and regarding the nature and frequency of various adjustments to the model.

Introduction

To account for the effects of inflation, the Companies believe that the expense cap model adopted in the Order should have a simple inflation factor applied annually, and that other adjustments should also be made, but less frequently than annually. The Companies believe that the independent variables in the adopted model – i.e., Plant In Service and Supported Households – are meaningful, appropriate metrics on which to base expense caps. Further, because these input variables will likely change little, if at all, from year to year, the expense cap for any particular company will be relatively constant, and readily predictable, from year to year.

Productivity in the telecommunications industry – especially the telecommunications industry in rural Nebraska – is difficult and costly to measure because of shifting trends in technology, consumer demand and other factors. The Companies therefore do not support the development of a productivity factor for use with the expense cap model.

In the following paragraphs, the Companies offer their recommendations regarding periodic adjustments to the expense cap model.

Responses to Questions Presented in the Order

1) **Should the Commission make adjustments for inflation? If so, should the Commission use the Chained Consumer Price Index (C-CPI) as suggested by RIC?**

The Commission has adopted an expense cap model that depends on two input variables – Plant In Service and Supported Households – to model the variation of company expense with company "size" in a fair and reasonable manner. From a temporal perspective, both input variables are unlikely to change much, if at all, from year to year. Supported Households will not change at all during the decade between U.S. Census Bureau studies, and Plant In Service typically changes very little from year to year for most companies. This stability in input variables has the benefit that the resulting expense cap, for any particular company, will remain relatively constant, and thus predictable, from year to year. Companies' actual expenses, though, are likely to be less predictable than the expense cap produced by the adopted model.

Going forward, the Companies are particularly concerned about the unpredictable effects of inflation, over which no party nor the Commission, has any control. To provide an allowance for such unpredictable variation in expenses, the expense cap model should be modified such that each company's cap is adjusted annually by a factor that reflects the general inflation rate.

While the Companies believe the Commission should modify the model adopted in the Order to account for the effects of inflation, they emphasize that they have not suggested using the Chained Consumer Price Index, nor any price index based on *consumer* prices, to adjust the model. Rather, in the pre-filed rebuttal testimony the Companies' witness recommended using the Gross Domestic Product-Chained Price Index ("GDP-CPI"), or some other generally used price index, to adjust the model.[1]

The Companies oppose using a consumer price index to adjust the expense cap model because such an index reflects the rise in prices of *consumer* goods and services, not of goods

[1] *See* Vanicek Pre-filed Rebuttal Testimony, p. 4.

and services generally. Housing costs, for example, constitute 42% of the consumer price indices published by the U.S. Bureau of Labor Statistics ("BLS").[2] Whereas the BLS consumer price indices are based on a fixed "basket" of consumer goods and services,[3] the GDP-CPI is based on all final goods and services produced in the Nation.

The price indices – in particular, the GDP-CPI – published by the U.S. Commerce Department's Bureau of Economic Analysis are commonly used by other government agencies, including the Federal Communications Commission ("FCC"), as a general measure of inflation. The FCC's Rural Growth Factor, for example, which depends on the GDP-CPI, affects the cap on High Cost Loop universal service support available to rural carriers.[4] The GDP-CPI is also used in annual calculations of another federal universal service program – namely, Long Term Support.[5] Lists of historical values for the GDP-CPI, updated quarterly, are available from the Economic Research Service of the Federal Reserve Bank of St. Louis.[6]

Because the GDP-CPI is a widely-accepted measure of general inflation in the U.S., is used by government agencies in a manner similar to that contemplated by the Commission, and is readily available to the public, the Companies recommend that it be used as an annual adjustment to the expense cap model adopted in the Order. Since the GDP-CPI is published on a quarterly basis, the Companies suggest that the Commission use a simple average of the four most recently published quarterly values as the annual inflation factor for use with the expense cap model.

---

[2] *See* Tables 1, 6 and 1C of "CPI Detailed Report – Data for June 2008," available for download from the U.S. Bureau of Labor Statistics web site at http://www.bls.gov/CPI/.

[3] The BLS introduced in 2002 a new index called the Chained Consumer Price Index for All Urban Consumers ("C-CPI-U"), whose "basket" of goods and services varies in order to account for the effects of product substitution. The C-CPI-U is, nonetheless, a measure of price increases in *consumer* goods and services.

[4] *See* Universal Service Administrative Company web site, at http://www.usac.org/hc/incumbent-carriers/step01/hc-loop-support.aspx.

[5] *See* 47 U.S.C § 54.303(4).

[6] *See* http://research.stlouisfed.org/fred2/categories/21.

2) Should the Commission develop an annual productivity factor?

As noted by the Companies' witness in the March 4 hearing in this proceeding, the quantification of productivity for mid-size and small Local Exchange Carriers ("LECs") is problematic.[7] The witness's pre-filed testimony stated:

> There are significant differences between Nebraska LECs that impact the productivity they are able to achieve. In general, larger LECs have greater economies of scale and experience greater productivity.[8]

The Companies' witness also noted the following counter-intuitive trends in the telecommunications industry that affect productivity:

> I'm not sure right now in the industry you're going to see very much positive productivity because one of the drivers of productivity is demand growth because productivity is output divided by input. And in -- when the FCC created the price cap productivity factor, you had a lot of growth. You had toll prices declining, and you had lots of growth in toll minutes. And you probably had people still adding landlines because they were using them probably at that point for dial-up internet service.
>
> So you had a lot of growth. And that tended to make the productivity factor pretty high.
>
> But look at the environment we're in now. Landlines are probably flat or maybe even declining because maybe there are – some people are taking them out, moving over to wireless.
>
> Your toll minutes are probably pretty flat, maybe declining, maybe growing just slightly. But you probably don't see a lot of productivity growth in the current environment.[9]

The Companies believe that changes in productivity can be accounted for through a recalibration of the model (see discussion below) and the Companies oppose the use of a productivity factor to adjust the expense cap model.

---

[7] *See* Vanicek Pre-filed Rebuttal Testimony, pp. 4-5. *See also* Hearing Transcript, pp. 47-57.

[8] *See* Vanicek Pre-filed Rebuttal Testimony, p. 4.

[9] *See* Hearing Transcript, pp. 47-57.

3) **Should Supported Households be recalculated when the Commission updates this figure in the NUSF-26 model? Should it be re-run after the next United States census information is made available?**

The Companies assume that, after new U.S. Census figures are available, the Commission will recalculate the number of households in each Support Area served by Nebraska's Incumbent LECs ("ILECs"), for use in the NUSF-26 Support Allocation Methodology ("SAM") for the distribution of NUSF high cost support to Nebraska Eligible Telecommunications Carriers ("NETCs"). This will provide a revised number of Supported Households for each ILEC that may be available from the SAM for use in the expense cap model. The Companies urge the Commission to utilize this process to obtain new Supported Households counts for use in the expense cap model.

The Companies also recommend that the Commission recalibrate the expense cap model at the time that new Supported Household numbers are made available through the process described above. The expense cap model would thus be recalibrated, but not recreated from scratch, by performing the same type of regression analysis, on a new data set-- as was done to produce the model adopted by the Order. The new dataset should consist of the most recent five years' worth of Plant In Service, Supported Households and Total Expense data for each Nebraska ILEC.

"Recalibration," means that a new set of model coefficients should be calculated through regression analysis, but that the selection of independent variables should remain unchanged. This recalibration of the model will serve to correct for any over- or under-adjustment of the expense caps resulting from application of the annual inflation factor as described above, and to also correct for any other factors not explicitly accounted for, such as productivity.

Conclusion

The Companies support the annual adjustment of the expense cap model adopted in the Order by an inflation factor. However, the use of a productivity factor is not appropriate because of the nature of rural telecommunications and may make the model unpredictable. The Companies believe that a recalibration of the expense cap model when the number of Supported Households is changed (based upon U.S. Census Bureau studies) will appropriately adjust the level of the expense caps and recognize changes in productivity.

Dated: August 4, 2008.

Respectfully submitted,

Arlington Telephone Company
Blair Telephone Company,
Cambridge Telephone Company,
Clarks Telecommunications Co.,
Consolidated Telco Inc.,
Consolidated Telecom, Inc.,
Consolidated Telephone Company,
Curtis Telephone Company,
Eastern Nebraska Telephone Company,
Great Plains Communications, Inc.,
Hartington Telecommunications Co., Inc,
Hershey Cooperative Telephone Co., Inc.
K&M Telephone Company, Inc.,
Nebraska Central Telephone Company,
Northeast Nebraska Telephone Company,
Rock County Telephone Company,
Stanton Telecom Inc., and
Three River Telco
(the "Rural Independent Companies")

By: ______________________

Paul M. Schudel, No. 13723
James A. Overcash, No. 18627
WOODS & AITKEN LLP
301 South 13th Street, Suite 500
Lincoln, Nebraska 68508
Telephone: (402) 437-8500
Facsimile: (402) 437-8558
Their Attorneys

CERTIFICATE OF SERVICE

The original and five copies of the foregoing Comments of the Rural Independent Companies were hand delivered on August 4, 2008, to the Nebraska Public Service Commission, 1200 N Street, Suite 300, Lincoln, Nebraska 68508, with a copy of such Comments mailed by first class mail, postage prepaid on the same date to Angela Melton, Legal Counsel, Nebraska Public Service Commission, 300 The Atrium, 1200 N Street, Lincoln, Nebraska 68508.

James A Overcash